operator's position. A response time of thirty days would provide a more reasonable opportunity for data collection and response.

If the franchising authority denies the requested change in status, then the cable operator may seek review of that decision at the Commission. However, the cable operator must be required to exhaust its administrative remedies at the local level before seeking review. Circumvention of the local process by requesting a change in competitive status in a petition for revocation should not be permitted.

F. Assumption of Jurisdiction by the Commission

At ¶ 29 of the NPRM, the Commission asks what procedures it should follow if it assumes jurisdiction over basic rates following a revocation or disapproval. The Minnesota Cities propose that for the sake of minimizing confusion and administrative burdens, the Commission should follow the same procedural rules and time deadlines which it adopts for use by franchising authorities. Likewise, cable operators should be required to file rate schedules with the Commission when it has retained jurisdiction, with copies to the local authority.

VI. BASIC RATE REGULATION PRINCIPLES

A. Discussion

Congress has issued a mandate to the Commission to promulgate regulations which must meet two tests: 1) result in rates for basic service which are reasonable; and 2) such reasonable rates for basic service cannot exceed rates which would be charged for the basic service tier if the cable system were subject to effective competition. *47 U.S.C. § 543 (b)(1).* Simply put, if basic service rates exceed that which would be charged in an effectively competitive environment, then they are unreasonable. Therefore, the Minnesota Cities must disagree with the proposition stated in ¶ 31 of the NPRM that Congress did not intend the Commission to give greater or primary weight to any of the statutory goals. Congress gave primary weight to the effective competition goal, which is intended to provide a ceiling or cap on basic service rates.

Congress also decreed that an overriding mandate was to reduce administrative burdens on subscribers, cable operators, franchising authorities, and the Commission. *47 U.S.C. § 543 (b)(2)(A).* Nevertheless, even this goal is subordinate to the goal of reasonable rates. Consequently, if the Commission's regulations produce a formula or benchmark that is easy to administer but does not provide a high degree of assurance that it will result in reasonable rates, the Commission will have failed in its mission.

At the outset, it is easier to determine what Congress did not intend. The Minnesota Cities agree that Congress did not intend that general use should be made of the rate base/rate of return method of rate regulation. In recent years, that approach has been the subject of increasing criticism for failing to induce telephone companies to become more productive and generate customer benefits. *See, e.g., Policy and Rule Concerning Rates for Dominant Carriers, Second Report and Order,* 5 FCC Rcd. 6786, 6787 (Sept. 19, 1990) (hereinafter "LEC Price Cap Order") Moreover, rate base/rate of return regulation has failed to prevent other monopolistic carriers, namely telephone companies, from engaging in cross-subsidization of unregulated services by regulated services. *Intergovernmental Regulation of Telecommunications,* Advisory Commission on Intergovernmental Relations, pp. 23-24 (July, 1990). Given these deficiencies, plus the burdens of time and cost in administering this form of rate regulation, it should be employed only when necessary.

Generally speaking, the benchmarking approaches proposed by the Commission, although easy to administer, are not without their drawbacks too. First, to the extent that the benchmarks focus on averages of rates rather than costs, they do not adequately consider all of the seven statutory criteria set forth in Section 623 (b)(2)(C), including direct and common costs, revenues, and franchise costs. Second, it is almost impossible for benchmarks to account for the individual characteristics of cable systems, such as age and type of plant, subscribers per mile, and number of channels included in basic tier. Third, for lower capacity systems with aged or obsolete plant and below industry-standard programming, benchmarking will not provide an incentive to upgrade plant and programming or to operate with greater efficiency. Indeed, in these situations benchmarking may even encourage **increased** rates for basic service without any offsetting benefit to subscribers. Fourth, to the extent that benchmarking relies on past unregulated rates, the inputs will be based largely on the experience of systems purchased at inflated prices with large quantities of high-cost debt. Fifth, benchmarking easily can be as complex and burdensome to apply as traditional cost of service ratemaking, particularly if it involves numerous detailed economic adjustment factors, such as the local service price index proposed in ¶ 38 and n. 70 of the NPRM.

Given the many disadvantages of benchmarking, the Minnesota Cities recommend that the Commission instead focus on simplified formulas based on individual system costs. This recommendation will be discussed after a brief analysis of each of the benchmarking approaches proposed by the Commission.

B. Benchmark Alternatives

1. Rates Charged by Systems Facing Effective Competition

Presently this is not a workable approach because of the paltry number of systems which have effective competition. Out of some 11,000 cable systems nationwide, only about 100, or less than one percent, would potentially be included in the pool of effectively competitive systems. *See, Sen. R. No. 102-92,* pp. 15-18 (53 communities have some overbuild, wireless cable systems operate in about 45 communities, DBS is unavailable, and telephone companies are incapable of carrying video programming into the home.) The Minnesota Cities wholeheartedly agree with the Commission's statement at ¶ 42 of the NPRM that its ability to devise a benchmark based on systems with effective competition will depend on the number of systems with competitive markets. The day when an effective competition benchmark can be devised has not yet arrived.

Moreover, it is more likely than not that the few systems which do have effective competition are found primarily in major metropolitan areas and hence would provide little reliable data on competition in rural areas or on smaller systems. Even regression analyses would have to depend almost entirely on hypothetical data.

2. Past Regulated Rates

Under this proposal, a benchmark would be developed based on rates charged for basic service before the '84 Cable Act abolished rate regulation on most systems. This approach appears to mimic the Commission's LEC Price Cap Order, which uses regulated rates in effect for telephone companies on July 1, 1990.

For the most part, this approach would have to rely on data which is a minimum of seven years old. It is difficult to conceive that such data would bear any resemblance to current circumstances in an industry which has been constantly evolving. For example, if cable operators have improved their operating efficiencies and productivity in that timeframe, that fact would not be reflected in the benchmark. As stated above, the Commission should not sacrifice accuracy for simplicity.

3. Average Rates of Cable Systems

Under this approach, an average per-channel rate would be developed for the **lowest** service tier(s) based on 1992 data for all cable systems. There is no discernible basis for adoption of this benchmark.

The most obvious defect of the average rate benchmark is that it would violate the express and implied intent of the '92 Cable Act. It would depend entirely on rates charged by cable operators with significant market power who purchased systems at inflated prices and over-leveraged themselves with debt. As previously stated in these comments, Congress intended to provide subscribers with rate relief now. It did not intend to perpetuate existing monopolistic rates indefinitely.

Additionally, the Commission contemplates applying this benchmark only to the lowest tier of service, rather than to any tier which includes retransmitted local broadcast signals. As discussed in Section IV above, Congress did not intend such a limitation.

Further, this approach fails to give any consideration, as the Commission had been directed to do, to **any** of the seven statutory criteria set forth in section 623 (b)(2)(C). Thus, the Commission lacks authority to adopt it.

4. Cost of Service Benchmark

This approach would employ engineering, operating, programming and other cost data to build the costs of an "ideal" or "typical" cable system. As such, it would eliminate some of the significant disadvantages of the benchmarks discussed above. It would take into account the cost, revenue, and profit factors listed in Section 623 (b)(2)(C)(ii)-(vii), while the effective competition factor in Section 623 (b)(2)(C)(i) would serve as the upper limit on the rate. It has the added benefit of allowing the Commission to discard as unreasonable the inefficiencies of existing systems, such as inflated system purchase prices.

Nevertheless, the amount of subjectivity inherently involved in building a "typical" system will make this approach the target of lawsuits from all sides. The Commission may find itself spending more time in court defending its "typical" system and fighting off stays than is worth the effort.

5. Price Caps

As proposed, price caps would be applied to future increases in rates initially set using other benchmarks. In ¶ 50 of the NPRM, the Commission asks whether this approach is consistent with the intent and legislative history of the '92 Cable Act.

While the Commission may have the authority and discretion under Section 203 of the Communications Act to adopt price caps as a means of setting just and reasonable rates for the telephone industry, it is not at all clear that this same authority exists to apply price caps in the cable industry. In Section 623 (b)(2), Congress very clearly defines the factors to be considered in establishing rate regulation methods. Not one of those factors even begins to suggest that cable operators should be entitled to automatic future increases in basic service rates. Further, Congress did not provide the Commission with discretion to add new factors not already included on the list.

Indeed, the proposed price cap mechanism hints strongly of the automatic pass-through mechanism previously advanced in rate regulation rules promulgated pursuant to the '84 Cable Act and soundly rejected by the U.S. Circuit Court of Appeals:

> We conclude, however, that erecting this pass-through mechanism exceeded the Commission's authority under section 623. That provision begins with the admonition that "[a]ny federal agency . . . may not regulate . . . rates except to the extent provided under this section." 47 U.S.C. sec 623 (a) [sic]. Given that delimiting provision, the FCC would seem to be impermissibly stretching the bounds of its lawful power when it uses a general direction to establish "standards for rate regulation" to justify direct regulation of the permissible amount of a rate increase.

ACLU v. FCC, supra, at 1570-71.

It appears as though the Commission is replowing old ground. Congress has established the parameters for regulating rates, and automatic price increases, whether by way of price caps or automatic pass-throughs, were not among them. The Commission must restrain itself from granting "gratuitous administrative largesse." *ACLU,* at 1571.

C. Individual System Cost-Based Alternatives

1. Direct Costs of Signals plus Nominal Contribution to Joint and Common Costs.

Under this approach, an individual system's costs would be used to define reasonable basic service tier rates in place of the benchmarking alternatives described above. Although cable operators would be required to maintain their accounting records according to generally accepted accounting principles ("GAAP"), this alternative stops far short of full-blown rate base/rate of return regulation and its attendant complexities. It offers a large measure of accuracy which does not come at the expense of ease of administration. It also adheres the most closely to all seven statutory criteria set forth by the drafters of the '92 Cable Act. For these reasons, the Minnesota Cities urge the Commission to adopt this alternative.

In establishing guidelines under this approach, a balance should be struck between the need to make available affordable service to low-income subscribers and the desire to provide an incentive to cable operators to structure the basic service tier to include what has become essential programming, such as CNN, C-Span, and ESPN. Allocations of joint and common costs therefore should neither attempt to recover fully distributed costs nor to hold rates to the bare minimum necessary to recover only direct costs. Further analysis of how the accounting standards set forth in Appendix A to the NPRM will be undertaken in the Minnesota Cities' Reply Comments.

2. Cost of Service

This approach relies on traditional rate base/rate of return regulatory techniques applied to public utilities for decades. The Minnesota Cities agree with the proposition stated at ¶ 57 of the NPRM that the widespread use of such an approach would be inconsistent with legislative intent because of the difficulties and high costs in applying it at the local level. If this were the primary means of rate regulation, it is foreseeable that many franchising authorities would not even attempt to use the process, or else would inadvertently misuse it. Obviously, this result would thwart the very underpinnings of the Act.

The Commission has proposed in ¶ 59 of the NPRM, however, that it adopt cost of service as a type of "safety net" to be used at the request of cable operators who wish to justify higher rates than could be achieved under the primary approach. The Minnesota Cities propose that this option should work both ways. That is, if a franchising authority determines that cost of service may produce rates **lower** than the primary approach, it may elect to use the former.

Although it is not anticipated that cost of service will be adopted as the primary approach, the Minnesota Cities offer a few brief comments on the cost of service standards proposed in Appendix B to the NPRM.

In ¶ 2 of Appendix B, the Commission asks whether the used and useful standard should apply to cable operators' rate base. The answer is an unequivocal "yes." For example, in situations where operators have deployed significant quantities of fiber optics, they have done so in order to offer signal compression or voice and data services. It cannot be seriously argued that the additional investment in fiber is "used and useful" to basic-only subscribers.

In ¶ 4 of Appendix B, the Commission asks whether it should limit a cable system's ability to recover goodwill from its subscribers by excluding some or all of it from rate base. Again the answer is "yes." Each of the systems represented by the Minnesota Cities has been bought and sold at least once in the last five years. In each of the most recent transactions, the purchase price exceeded the original plant investment by a factor of several times. Should this premium be included in rate base, it will reward the cable operators for paying prices based on monopolistic expectations. Traditional rate base/rate of return regulation allows a return only on the depreciated original cost of plant. There is no reason to depart from this norm in the cable setting.

In ¶ 5 of Appendix B, the Commission asks for comments on the rate base treatment of customer equipment. The Minnesota Cities recommend that consistent with the traditional rate base/rate of return approach, customer equipment be included in rate base rather than being expensed. In addition, labor associated with the installation of the equipment should also be capitalized.

With respect to ¶¶ 10 and 11 of Appendix B, the Commission asks for comments on the comparative risks of investing in providing basic and cable programming services vis-a-vis the Standard & Poors 400 industrial companies. The risk of investing in cable is certainly no greater than the risk of investing in any Standard & Poors 400 company, even after one factors out the change in regulatory climate. Indeed, the risk may be lower at present given the lack of competition. Accordingly, it would be fair to use the same approach adopted by the Commission in the 1990 LEC Represcription Order of using the S&P 400 to establish the cost of capital for cable operators.

VII. REGULATION OF RATES FOR EQUIPMENT

A. Division of Jurisdiction

The Minnesota Cities urge the Commission to clarify through its rules the fact that franchising authorities have been given the jurisdiction to regulate equipment rates along with other rates for providing basic service. While they believe this conclusion is inescapable from the '92 Cable Act's legislative intent, there are likely to be disputes over the issue unless the rules specifically address it.

The fact that Congress provided for franchising authorities to regulate equipment charges is established by the following language from Section 623 (a)(1) of the Communications Act:

> Any franchising authority may regulate the rates for the **provision of cable service, or any other communications service** provided over a cable system to cable subscribers, but only to the extent provided under this section. (emphasis supplied)

Moreover, Section 623 (b)(3)(A) specifically provides for the Commission to establish standards for determining the rates for the installation and lease of equipment used by subscribers **to receive the basic service tier.** Even more important, the latter subsection has been included in the section of the statute, 623 (b), which deals exclusively with standards for rate regulation by franchising authorities. The Commission's own jurisdiction to directly regulate rates for cable programming service has been reserved for Section 623 (c).

Any other result would be nonsensical. If the Commission had exclusive jurisdiction over equipment charges, then the reasonableness of those rates could be challenged only by way of a complaint filed with the Commission by a subscriber or franchising authority. Not only would such an approach be procedurally inefficient and time-consuming, but it would be inconsistent with Congressional concern over equipment issues demonstrated by Section 624A of the Communications Act, which deals with consumer electronics equipment compatibility.

B. Standards for Leasing and Installation of Equipment

In ¶ 63 of the NPRM, the Commission seeks comments on whether the rates for installation and leasing of equipment should be unbundled. The Minnesota Cities support the establishment of unbundled charges, which will open up competitive markets and will assist the Commission and franchising authorities in preventing overcharges.

In ¶ 65 of the NPRM, the Commission asks for identification of customer equipment which is not used [at least in part] to receive basic service. Further, the Commission asks for comments on the appropriate treatment for rate regulation purposes of equipment used for both the provision of basic tier service and cable programming service.

There should be no question regarding the assignment of ordinary converter boxes, remote controls, additional outlets, and inside wiring to basic service and the jurisdiction of franchising authorities over rates charged for this equipment. The thrust of the Commission's question goes to the assignment of addressable converters. The Commission need not look any farther than Section 623 (b)(3)(A) for the self-explanatory answer to that question. Congress has expressly directed the Commission to adopt standards based on actual cost for the price or rate for "such addressable converter box or other equipment as is required to access" programming offered on a per channel or per program basis. Clearly the Commission has jurisdiction over the entire addressable converter.

In ¶ 66 of the NPRM, the Commission seeks comments on the amount of general administrative loadings and profit which should be assignable to equipment. The Minnesota Cities recommend employment of the same approach that it recommended for establishment of basic service rates, *i.e.*, direct costs plus a nominal contribution to overhead. Further discussion of the appropriate amount of a nominal contribution will be included in the Minnesota Cities' Reply Comments.

VIII. *COSTS OF FRANCHISE REQUIREMENTS*

In ¶ 73 of the NPRM, the Commission concludes that it is not required by Congress to establish separate cost-based charges in addition to basic service for costs attributable to meeting franchise requirements. The Minnesota Cities agree with this conclusion. The Commission has been directed by Congress to establish regulations simply to **identify** such costs. *47 U.S.C.* § *543 (b)(4)*.

The Minnesota Cities disagree, however, that the identification of such costs should necessarily include a "reasonable allocation of overhead." This is particularly true if the cable operator's obligations are limited to contribution of funds, equipment, and/or channel capacity for PEG access. Only if the cable operator is required to provide services, such as maintenance of equipment, should any consideration be given to an allocation of joint and common costs. Under no circumstances, however, should cable operators be viewed as earning a "profit" from the provision of franchise requirements.

IX. CUSTOMER CHANGES

As an initial premise, the Minnesota Cities propose that Commission regulations specify that there be **no** charges assessed for changing service tiers within 30 days following any retiering. In addition, where addressable converters are available, the Commission should establish a nominal benchmark rate of no more than five dollars. Where the system or individual subscriber does not have an addressable converter, the formula should allow recovery of the direct costs of the service provided, plus a nominal contribution to joint and common costs. The service should not be priced out using a fully distributed cost, since that method would most likely result in high charges which act as a deterrent to downgrades and disconnections. Moreover, there is nothing wrong with requiring the operator to assign the majority of all overhead and profits to cable programming and premium services. This is the principle on which most businesses operate -- just as the cost of a store is recovered through products sold rather than by charging an admission fee or exit fee at the front door.

X. IMPLEMENTATION AND ENFORCEMENT

In ¶ 80 of the NPRM, the Commission proposes to apply the same schedules employed in telephone proceedings to rate filings in the cable sector. Thus, within 120 days after filing of rates by the cable operator, the franchising authority would have to review and approve or change rates. Although the Minnesota Cities agree that a deadline for reviewing rate filings is appropriate, the proposed 120 day period is insufficient, particularly with respect to initial filings.

During the initial round of filings, franchising authorities will require additional time to adopt ordinances consistent with Commission rules regarding rate regulation, and to review the scope and meaning of the newly adopted rules. At a minimum, 180 days should be provided from the time the operator files its rates with the authority, and such filing should occur until after the authority has become certified by the Commission.

With respect to proposed increases in basic service rates in the future, the Commission correctly observes in ¶ 81 of the NPRM that the 30 day notice period provided in Section 623 (b)(6) does not set an outside limit on the time for a franchising authority to render its decision. The Minnesota Cities propose that Commission rules provide that within that 30 day period, a franchising authority notify the cable operator in writing if the authority intends to accept the rate filing for further review and if so, whether it intends to suspend the proposed rates in whole or in part, or whether the rates will be allowed to take effect, in whole or in part, subject to refund. One possible approach would be to allow rate increases of 5 percent or less take effect subject to refund, while rate increases of greater than 5 percent would be suspended in whole or in part, with the balance to take effect subject to refund. Nothing would prevent the operator and franchising authority from reaching a voluntary agreement extending the period of time for consideration of the proposed increase.

The Commission also seeks comment in ¶ 83 of the NPRM on whether certain price changes caused by "factors outside the operator's control" should be permitted to be passed through without prior regulatory review. As mentioned in Section VI__ above, any pass-through proposal is an impermissible stretching of the bounds of the Commission's lawful power. *American Civil Liberties Union v. F.C.C., supra*, at 1571.

In order to facilitate franchising authority review of proposed rate increases, cable operators must be required to file documentation of the basis for their requests. The exact nature of the filing can be known only after the Commission determines which approach to rate regulation it will adopt. At a minimum, however, the operator must provide a detailed narrative explanation of the reason(s) for the increase together with appropriate financial documentation. It must also be made clear that the cable operator bears the burden of proof that the amount of the proposed increase is justified.

In ¶ 86 of the NPRM, the Commission asks a series of questions relating to franchising authorities' powers to establish rates other than those proposed by the operator, and to order refunds. The Minnesota Cities submit that these powers are inherent in the ratemaking function, and that in their absence, ratemaking would become an endless guessing game whereby the operator would have to submit proposals over and over again until the franchising authority agrees with the rates. This wasteful pattern would operate to the detriment of the franchising authority, the cable operator, and the subscribers. Further, franchising authorities should be permitted the discretion to apply the penalty provisions of their own franchise ordinances in the event that cable operators violate valid orders. The realm of such penalties generally would include the assessment of fines and, if necessary, termination of the franchise for violation of a material provision.

The Commission also seeks comments at ¶ 87 of the NPRM on the appropriate forum for appeals of local authorities' rate decisions. As the Commission already determined in its most recent rulemaking on the subject of rate regulation under the '84 Cable Act, appeals should be handled by local courts. *47 C.F.R. § 76.33 (a)(5)*. The Minnesota Cities agree with the view that local courts, through declaratory judgment actions, have the ability to resolve local disputes without forcing subscribers and franchising authorities to take their cases to Washington, D.C. at great expense. Moreover, if Congress intended that alleged violations of the Cable Act were to be remedied anywhere other than in the courts, it would have so provided. Commission jurisdiction over basic rates has been limited to the promulgation of rules and to setting rates where local authorization has been disapproved or revoked. It is also uncertain whether the Commission has the resources to expeditiously handle multiple appeals from all over the country in addition to all its other new responsibilities under the '92 Cable Act.

With respect to the Commission's request for comments at ¶ 89 of the NPRM regarding methods for notifying subscribers of the availability of basic tier service, the Minnesota Cities agree that initial written notification should be provided within 90 days or three billing cycles of the effective date of the rules as well as in pre-sale literature. Additionally, notification should be provided annually thereafter and within 30 days of a local authority's final decision regarding a requested increase in basic service rates. Periodic on-air announcements should also be required during prime viewing times.

XI. PREVENTION OF EVASIONS

Since the date of enactment of the '92 Cable Act, there has been widespread activity by cable operators to retier their service offerings and to raise rates. This conduct has already attracted the attention of a number of U.S. Senators, who have written to the Commission condemning it. *See, "Cable Rate Hikes Not Basic to FCC", Multichannel News,* Dec. 14, 1992, p. 1.

For example, Continental Cablevision of St. Paul, Inc. recently announced rate increases from $4.95 per month to $9.95 per month for its lowest tier of basic service, increasing the per channel cost of this service by 101 percent. *"Regulation Poses*

Questions for Providers, Subscribers," Minneapolis Star-Tribune, January 10, 1993, p.3D. In addition, Northland Cablevision has announced that its Grand Rapids system will be retiered effective April 1, 1993, although it has not disclosed the manner in which the system will be retiered. That system has been on a single tier of service since it was originally constructed in 1964.

In ¶ 127 of the NPRM, the Commission seeks comments regarding on how it can prohibit unjustified rate increases that through retiering might otherwise evade its rate regulation regime. The Minnesota Cities urge the Commission at a minimum to adopt regulations which provide: 1) that franchising authorities have the power to reduce rates for basic service to reasonable levels; and 2) create a rebuttable presumption that any combination of rate increases and/or retiering between the Cable Act's date of enactment, October 5, 1992 and the effective date of the Commission's regulations, April 3, 1993, of greater than ten percent per channel shall be deemed unreasonable.

XII. CONCLUSION

The forgoing comments will be supplemented by the Minnesota Cities Reply Comments in this docket which will be submitted on or before February 11, 1993. Specifically, the Greater Grand Rapids Area Cable Commission, and the Cities of New Ulm, Minnesota and Savage, Minnesota will file additional comments on the proposed Cost Accounting Standards contained in Appendix A to the Notice of

Proposed Rulemaking, as well as on the proposed method for regulating Cable Programming Services.

Dated: January 26, 1993

Respectfully submitted,

Hessian, McKasy & Soderberg, P.A.

By Susan Rester Miles
Susan Rester Miles

4700 IDS Center
Minneapolis, Minnesota 55402
Telephone: (612)330-3000
ATTORNEYS FOR GREATER GRAND RAPIDS AREA CABLE COMMISSION, AND CITIES OF NEW ULM, MINNESOTA, AND SAVAGE, MINNESOTA

32144-1